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THE PICTURE: Gad, the bunk and nonsense you read and hear as this bull market fights its way higher. I guess the most common drivel is: "First this market was earnings driven, but now it's interest rate driven." Sounds good, doesn't it? You see, newspapers and radio and TV have a problem. The problem is that people want to know exactly WHY the market is moving up or down. Now, the real reasons for any market movement are SELDOM KNOWN at the time, and every Wall Street professional is aware of this. But mere market action isn't enough for the public -- the public above all wants to know WHY.

So faced with the "why problem," the media comes up with a solution. It dreams up answers to the why question or calls various Wall Street "experts" for the supposed answers. The experts, anxious for publicity (any publicity), oblige by dreaming up their own anwers or by repeating the latest rumors. And so the nonsense goes on.

How does all this apply to today's market? The fact is that this is a bull market and in a bull market news goes with the trend. In other words, things have a habit of WORKING OUT when the primary trend of the market is bullish. Thus, news of strikes, lay-offs, tax changes, mergers, money supply explosions, money supply declines, leading indicator statistics, any or all of these tend to be interpreted bullishly by a bull market, because that's how bull markets work -- they tend to go up on either good news or bad news, take your choice! You see, a primary bull market will use almost any excuse to advance -- particularly if advancing market action is the opposite of what the public expects.

I've written about this before, but I want my subscribers to thoroughly understand it so I'm going to repeat it. The old adage that "a bull market climbs a wall of worry" is absolutely correct. Yet few people really comprehend the meaning of that statement. Consider this: If a bull market really does climb a wall of worry, why is everyone sitting around praying for good news (instead of praying for more worries)? The answer: The vast majority of people simply don't understand how markets work.

Remember this: The function of the market is TO DISCOUNT, TO LOOK AHEAD. The stock market does not act on yesterday's statistics or today's hot news -- the market acts only on investors' perceptions of TOMORROW.

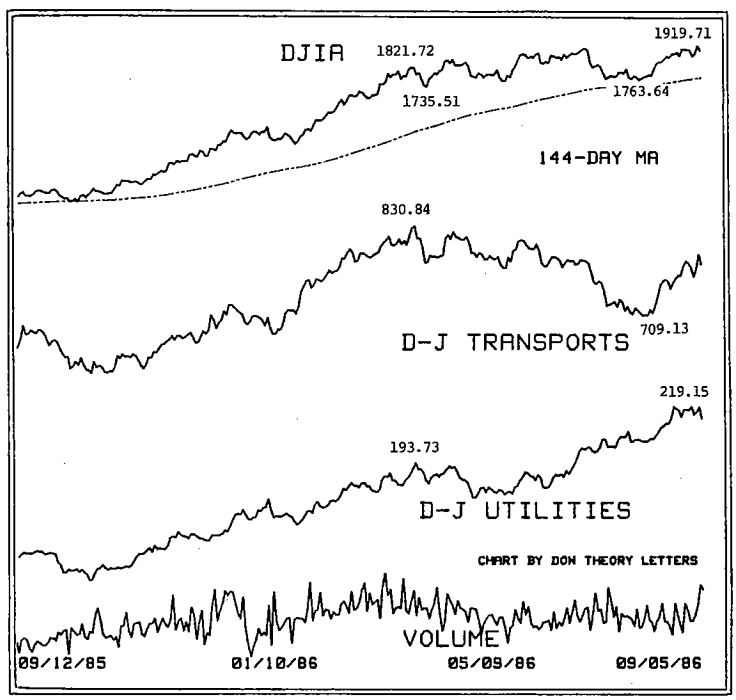
Thus, today's rising market is a reflection of conditions as investors perceive them six months or a year from now, and the market couldn't care less about what today's Wall Street Journal says. A few days ago I heard a well-known economist state on TV that "the stock market isn't going any higher because economic conditions don't warrant higher prices." Can you believe it? And this dolt is on TV, spouting his ignorance to information-hungry Americans! Obviously, the guy just doesn't understand how markets work; he doesn't know that the market's function is to DISCOUNT. But I guess that's par for the course. All I really want is for my own subscribers to be able to laugh at this kind of ignorance.

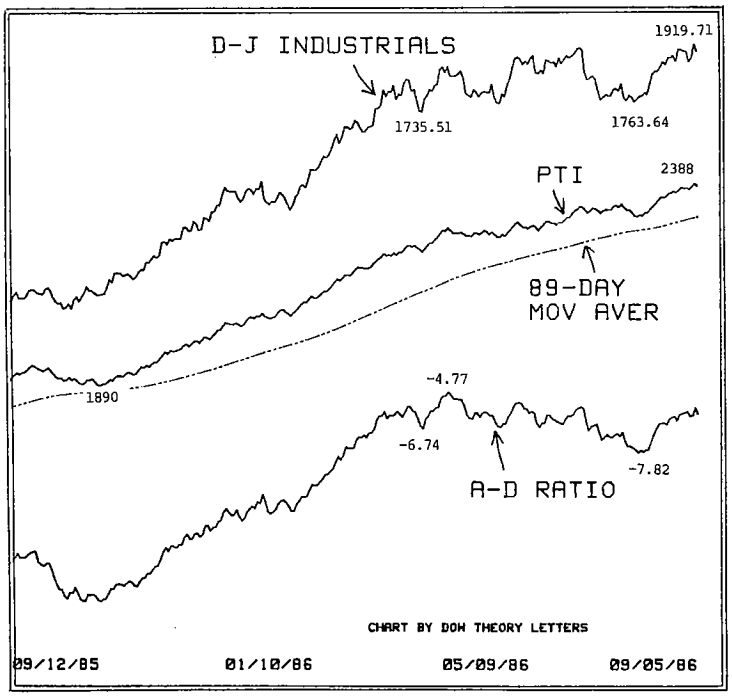
A primary bull market is built on the perception that the broad trend of business is UP, and that somewhere ahead, maybe a year or two years or 10 years ahead, everything is going to finally come up roses. That economic rose garden (ironically) is what we call THE TOP. At the top, the sky is clear blue, the roses are blooming, the New Era has arrived, and it is generally conceded that all life's problems have finally been solved. And wonder of wonders, at that point informed investors will be selling out and getting into cash. Why? The reason is obvious -- if conditions can't get any better, they can only get worse. And if they can only get worse, these informed investors want to watch the deteriorating show from a box seat on the sidelines.

The moral: Don't curse today's bad news. In fact, do the opposite -- hope the rotten news lasts. Because rotten news WITHIN A BULL MARKET means that the bull market is going to be held back (or correct) and it is going to last a lot longer. For that reason, as the news ultimately gets better and better, we will increase our vigilance, our feeling of uneasiness. Finally, when "happy days are here again," we will sell out. We will sell out because wild, crazy, happy days on Wall Street almost always coincide with the death of the bull.

But right now I think we can rest in peace. The news is still scary, the short interest on the AMEX and the NYSE is still high and rising, people are still worried about the Russians and Khadafi and South Africa. Furthermore, Americans are still shaking their heads over the low price of oil, the shaky bank situation, the horrendous US balance-of-payments deficit and the generally lousy shape of US business (and most recently the plight of the formerly-rich Texas families).

But with it all, this bull market is marching to a different tune (as every good bull market should). That tune is as follows: "Despite the depressing 1986 economic picture, blue skies lie somewhere ahead -- maybe in 1987 or 1988 or 1990." Obviously, we don't know when the blue skies are fated to appear -- that would be too much to ask. But we don't have to know when. It will be enough





if we can just IDENTIFY those blue skies when they finally arrive.

Question: I see the Fed is flooding the market (i.e., the banks) with money. Obviously, the Fed is worried about business and the economy. If the Fed is so worried, shouldn't we be worried too?

Answer: The Fed is attempting a very difficult balancing act. If the Fed goes conservative on the money supply, the US economy could topple into a recession or worse. If the Fed boosts the money supply too far, the dollar could cave in. So we're watching the Fed walk a monetary tightrope, and we all hope it will succeed.

But as I've said over and over, I don't operate on the basis of the Fed's action or on what some name-economist may think about the Fed's action. I operate on the basis of what the market is telling me. And so far, the market is telling me that the bull is in command and that somehow (Fed or no Fed) things are going to get better.

Question: I note that the latest (July) figures for the US balance-of-payments show a deficit of $18 billion or an annualized deficit of over $200 billion. Isn't that a prescription for disaster?

Answer: If it is, the market doesn't see it (at least not yet). By the way, the much lower valued dollar will exert a beneficial effect on our balance-of-payments situation, but that's going to take TIME. My optimistic guess is that sometime in 1987 the B-O-P figures are going to get better, maybe quite a bit better. So be patient.

Question: Won't the new tax bill be bad for business, I mean without the investment tax credit and minus the benefits of fast depreciation and so forth?

Answer: Personally, I don't think much of the new tax bill. But the market couldn't care less about my opinion (and my opinion could also be dead wrong). I further believe that the market has thoroughly discounted any adverse effects of the new tax bill.

CURRENT MARKET NOTES: In the last Letter I underscored the danger points for the Averages (and the market). Those danger or bear points are still 709.13 for the D-J Transportation Average and 1763.64 for the D-J Industrial Average -- although as explained in the last Letter I would prefer the April 7 low of 1735.51 as the bear point for the Industrials.

Here is a very important point to consider and comprehend: As long as a bull market is in force (in other words, as long as NO primary bear signal has been given) it is reasonable to expect the major averages to climb to new highs -- all in due time. This concept was (and is) really the secret to understanding this market all during 1986. Let me put it a different way: A bull market that won't reverse itself is going to take the averages to new highs regardless of news, views, pessimism or anything else. It's a simple concept but one that escapes the vast majority of amateurs and professionals.

On September 4 the NYSE surprised nearly everyone with a sudden and massive surge. The surge took the Dow to a record high of 1919.71. It also took the S & P 500 Composite, the D-J 65 Composite, and the NYSE Composite to record highs. My PTI also rose to a record high of 2385.

What was the meaning of these multiple new highs? Here is the way I see it. Remember, the A-D ratio topped out on April 21, more than four months ago. Many bearish analysts, noting that the A-D Ratio traces the advancing or declining tendencies of the majority of stocks on the NYSE, now claim that a bear market began back on April 21 -- because that was the date when the majority of stocks topped out. They also argue that since April 21 the stock market has been subject to a bearish and continuing divergence between price and breadth.

I too note all of this. But I ask myself, "Is it logical if a bear market began on April 21 to see the Dow plus my PTI plus the S & P 500 plus the D-J Composite plus the NYSE Composite all advance to record highs -- and this bullish action occurring four months AFTER the peak in the A-D ratio?"

My answer is that with so many major averages and indices rising to new record highs, logic tells me that the bull market is still in force and that the primary trend of the market remains up.

"What about the Transport non-confirmation?" you ask. The Transports on September 4 closed at 790.13, a fat 40 points below their record high of 830.84. And my answer is "Yes, we have a definite major non-confirmation, but that non-confirmation alone hardly signals that the bull market is over. In the majority of cases, a primary penetration of one Average will be confirmed (in due time) by the other Average. Furthermore, we must give the primary trend (in this case the bull trend) every benefit of the doubt."

INVESTMENT POSITION: Yes, I know that everyone is calling for a big correction or even a bear market, but despite the prevailing bearishness -- the bull is still firmly in the box. Now here's a very important consideration. I obviously can't prove it, but I'm betting that oil has seen its lows. I base this on the inflationary action of the metals, I base it on the action of crude oil on the charts, and I base it on the action of the oil stocks.

In fact, I wouldn't be surprised if the oil stocks led on the next major move in this bull market. Two of the oil stocks that I have recommended repeatedly, Royal Dutch and Exxon, are now hitting new highs. Petroleum Resources (PEO -- a closed-end energy fund on the NYSE) has hit a new high and its convertible preferred (PEOA) has also hit a new high. I again recommend both PEO and PEOA. Both of these represent clean and easy ways to participate in any oil resurgence, and in my opinion "oil will rise again."

TIME: You've all heard this one. The Indians received $24 for Manhattan Island. If they had put that $24 in a bank at compound rates of interest and just kept it there, they'd now own all of Manhattan and probably the rest of the USA as well. All that example demonstrates is the power of compounding rates of interest on money THROUGH TIME.

Most investors don't realize it, but if you had enough TIME, there would be absolutely no sense in putting your money in anything but the safest and stodgiest investments. Today that would be

Treasury bonds or top-grade municipal bonds. One hundred years ago it probably would have been top-grade railroad bonds.

The point of this discussion is that when we invest in anything but the SAFEST fixed-income instruments, what we are really trying to do is to BEAT TIME. In other words, if you and I had, say, another 100 years to live, there would be absolutely no sense in buying a common stock or any other speculative vehicle. We'd simply put every nickel we could save in T-bonds or muni bonds, knowing that within 50 years we'd be wealthy, and by the time 100 years came around we wouldn't know what to do with the money. We'd be up to our ears in greenbacks.

Keeping this whole thesis in mind, we must then realize that investing is really a balancing act in which we try for (1) safety, plus (2) income, plus (3) appreciation.

Why do I mention safety first? Because the most basic law of investing is that you must not lose your capital. Capital is the basic TOOL of the trade. You may research your head off and come up with the investment of the century. But without capital you've wasted your time. Without capital you can't do a thing, and all your work has gone for naught.

Next, why income? Because without income there is no compounding. And compounding through time is the only guaranteed way to riches. That's why I insist on defining an investment as something that pays you a rate of return. Most people can't seem to understand this concept, but it must be understood. Gold is not an investment, a house is not an investment (unless you rent it out), a stamp collection is not an investment. They all represent "things of value" and any or all of them may appreciate over time. Indeed 20 years from now your house or your stamp collection may be worth more than a comparable value (purchased today) in Treasury bonds. BUT in buying the house or the stamps you are missing the CERTAINTY of appreciation -- of compounding through time. And again I say that the compounding through time concept is critical in investing.

Finally, why do I say that appreciation is the third item we strive for in attempting to beat time? Well, obviously, appreciation is the essence of how we attempt to beat time. If we are smart enough to be able to buy a stock that doubles in a year, we have beaten time. Let's make a current comparison. At today's rates we can buy a safe, highly-rated Treasury bond which will yield up to 7.7% if we hold it long enough. At 7.7% that bond will double in value in 10 years. So we have accomplished with a stock in one year what it will take us 10 years to do with a T-bond -- namely double our money before taxes. What, then, has the purchase of this winning stock done for us? It has simply beaten time in terms of doubling in value.

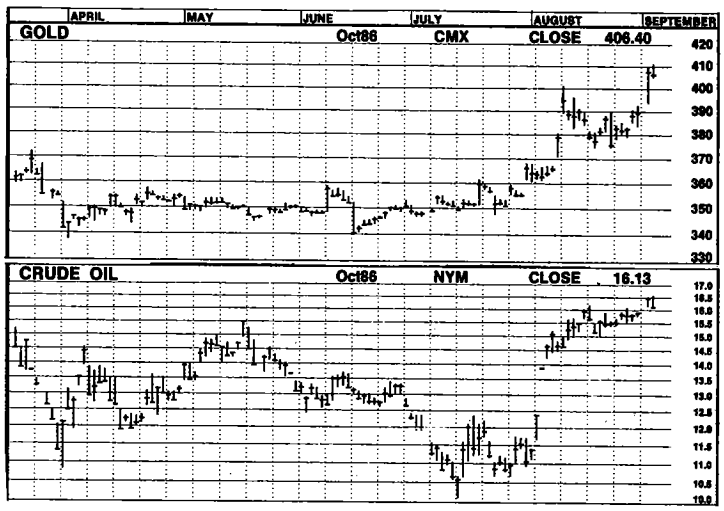
So for the intelligent investor, accumulating equities in a bull market is the ideal way to beat time. Conversely, avoiding a bear market (by being in T-bills or some other safe instrument) is an ideal way of operating, because in a bear market the price of things and the cost of living both go down. Therefore, the investor who can freeze his assets, stand still so to speak, is actually increasing his buying power. Therefore, time (in this case, the collapse of tradable values) is a plus for the investor who is smart enough to hold his own in terms of buying power.

Incidentally, with the new tax bill almost a certainty, the emphasis should now be increasingly on income rather than possible appreciation or anything else. The reason is obvious: the new tax bill pushes up the tax on capital gains, but it lowers taxes on income. Thus, bonds, utility stocks and high-yielding safe stocks should become prominent in portfolios. Trading, speculating, gambling, appreciation will be less interesting from the standpoint of the new tax bill. The hottest items around from now on can be described by three words -- SAFE, HIGH, INCOME.

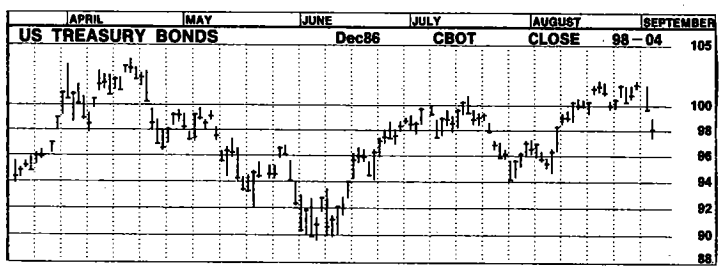
CHARTS: The widely-watched CRB Commodities Futures Index (27 different commodities) has been creeping up from its recent low below 200 to last week's level of 209. My guess (based on the STEADY UPWARD CREEP) of the Index is that we've seen the low for the majority of commodities -- at least for quite a while.

First let's turn to the two items everyone watches, the metal gold, and oil (often called "black gold"). The chart of crude oil (Oct. contract) shows the crude rallying bullishly over 15.50 (15.50 was the last major peak) for a clear breakout into the 16 area. Oil has built a pretty good base for itself, and it wouldn't surprise me to see the crude now work itself up to around 20.

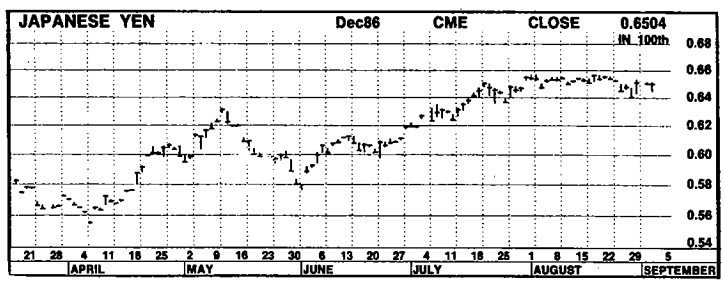
I show the gold chart here under the oil chart for purposes of comparison, but turn to page 6 for more on gold.



The December T-bond contract pushed over 100, held for a few weeks, then broke sharply below 100 again. As I stated in the last Letter, I expect the bonds to simply consolidate at a high level, and yes, I am skeptical about any forthcoming new high in the bonds.



The Japanese yen may well be the reserve currency of the future, this despite the fact that the Japanese don't want it to happen. But strength goes with strength, and if the yen remains this strong, investors are going to hold it as a store of value and as a hedge against the dollar.



But wait -- examine the chart of the yen. To me the yen is beginning to look a bit toppy, and if the December contract breaks below .64 I'd say the yen would look decidedly toppy. The strong US stock market may now be boosting international confidence in the dollar. Moreover, the dollar is now very over-sold. Still, nobody expects a big rally in the dollar. But a big dollar rally wouldn't surprise me at all.

Finally, meats have been strong, cotton and lumber look a lot better, and even the grains look like they could rally. All in all, mark me down as saying the commodities in general are moving into a bull phase. If it happens, you're going to hear shouts of "Here comes inflation again." Will the shouters be correct? I honestly don't know, but my guess is that a general commodity advance from here will represent more of an intermediate rally than a new bull market. But I've been wrong before.

OIL: I've recommended Exxon many, many times over the last few years. I bought Exxon myself back in 1982 at $28 a share on the basis of its well-covered $3 dividend -- at that time I recommended it as a valid substitution for bonds. More recently I recommended Exxon at 58-60 on the basis that this rich, extremely well-managed company would probably benefit from the oil crisis and ultimately come out ahead. How? I guessed that Exxon would be in the market to accumulate cheap or bankrupt oil assets at 10 cents on the dollar. If you haven't bought it by now, however, I'd hold off.

On August 28 it was announced that Exxon has an aggressive new CEO, Lawrence Rawl . I include a few excerpts from a USA Today article on Exxon (which has revenues in first-half 1986 of $40.2 billion, net income of $2.8 billion and earnings of $3.90 per share).

Like its lean-and-mean tiger, Exxon Corp. is set to prowl for new properties under Chairman-elect Lawrence G. Rawl.

"They're sitting there ready to pounce," said Thomas Stakem, an investment counselor at Congress Assets Management Inc. of Boston.

On Jan. 1, Rawl will replace Clifton C. Garvin Jr. as chairman and chief executive of the world's second-largest company (behind General Motors Corp.), with $86.7 billion in 1985 sales. Senior Vice President Lee R. Raymond will become president.

Likely targets of a Rawl-led acquisition binge: inexpensive oil and gas reserves, not companies. "Exxon won't get into a messy takeover or anything," said analyst Jim O'Mealia at Argus Research Corp.

Garvin steps down at the end of an industry crisis, said Don Fernow at Thomson-McKinnon Securities. "We're at the threshold of renewed growth."

Exxon is in better shape to take advantage of that than other energy companies. It has $2.5 billion in cash, a low $4.8 billion in long-term debt and respectable first-half profits of $2.8 billion ($3.90 a share).

"They are one of the real quality companies out there," said O'Mealia. One reason: Exxon began cutting costs and staff in 1981 — long before most competitors.

Despite the oil crisis, Exxon's stock has jumped 29% in the past six months. It closed Wednesday at $69⅜, up 1⅜.

Analysts, generally, are bullish on the stock. Even if oil stayed under $16 a barrel, Exxon would retain its $3.60 annual dividend, said Stakem.

Exxon isn't the only one looking for bargains in the decimated oil industry. A number of individuals are playing "vulture" in the Southwest, buying up "bargains" in oil field equipment. One such individual was described in the August 27 Investor's Daily. He's John Cassidy. At auctions Cassidy is paying less than a penny on the dollar for drilling rigs, draw works and 40-pound gears. Is Cassidy a genius or a fool? Only time will tell (I happen to think he's going to be right). Here's a clip from the Investor's Daily piece:

> According to the Petroleum Equipment Suppliers Association, Cassidy has a bigger stock of major drilling equipment than the top eight manufacturers together; by some estimates there's enough equipment to put 3,000 people to work.
>
> **Truckloads Of Equipment**
>
> In the past year, some 1,000 truckloads have unloaded at his Stroud junkyard. Some have carried a collection of $15 million worth of drilling gears, which Cassidy bought for about $28,000. Some have carried draw works, the machines that raise and lower pipe on the rig, bought for $10,000 to $20,000. Each originally cost about $400,000.

NOTES & QUOTES: In an absolutely astounding statement, Chairman Dan Rostenkowski of the House Ways and Means Committee announced (Sept. 4) that a national sales tax or a VAT tax was out, and "that everyone knows we will eventually need a tax increase ... but the increase in revenue should come through higher progressive rates, not by a low, regressive tax on need." Thus, before the new tax bill is even voted into law, Rostenkowski is saying that we should raise the tax rates that the new bill seeks to lower! So what everyone fears appears to be our fate. First, the new bill will take away all our tax write-offs, and then the boys in Congress will raise the rates. The Sept. 5 WSJ quotes Calif. Rep. Matsui: "I'm surprised at the lack of enthusiasm among constituents for the bill approved by the conferees." Is he kidding? In view of Rostenkowski's statement, what in hell is there to be enthusiastic about?!

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Life in the United States: How do kids under 15 get hurt? In 1984 (the last year of the statistics) 385,000 kids under 15 were treated in hospital emergency rooms for bicycle accidents. Skates were second with 65,000 accidents. Sleds produced 23,000 accidents and skateboards 13,500. ... What section of the US is doing best economically? No question about it, it's New England. In May the states with the lowest rates of unemployment were New Hampshire at 3.2%, Rhode Island with 3.4%, Connecticut with 3.5% and Massachusetts with 4%. Why is New England doing so well? Ten years ago it started getting out of heavy industry. Meanwhile, New England has been building up its defense industry. Unemployment rates in New England are now so low that lack of workers is actually hampering industry growth. In booming New Hampshire another factor is helping. New Hampshire has no sales tax and no income tax (it has a tax on dividends and interest above a very high threshold, plus a high real estate tax).

* *

Housing prices have slipped four months in a row and are now at their lowest level since last fall. Paradoxically, this is not true of home prices. Average sales price of a single-family home was $86,500 in 1982, $97,100 in 1984, and a record $116,900 this year in 1986.

* *

This week's shocker (From the Sept. 3 NY Times): "New statistics show that Japan is now the world's leading creditor nation. Its banks currently own 8% of the $2 trillion US banking business and account for a quarter of all British banking transactions. A single Japanese securities firm -- Nomura -- is responsible for financing nearly one-third of the entire US national debt. ... An unprecedented bull run abroad has broken out among Japanese investors, which if maintained at its present pace, would see Japan eclipse the US as the world's leading international investor by the end of the decade."

* *

Want a guaranteed way to halt massive shipments of narcotics into the US? Sure, what do we have to do? Simple: totally cut off foreign aid to any nation that does not cooperate fully with the Drug Enforcement Agency or the FBI in halting the growing of drug crops and the processing of those crops within a given nation's borders. Will this happen? Forget it! Why? Because the US is afraid of toppling these governments, which are (economically) very dependent on drug sales. If the "druggie nations" fall, they will take many major US banks with them, and that's the last thing the US wants. So the drugs continue to come into the US by the ton and by the carload and we continue to read about those "dramatic drug busts" on our borders and in our cities. But border policing and local busting of dealers and pushers will never halt the drug invasion. The only thing that will halt it is massive pressure on those nations that making a living by flooding the US with narcotics (plus, of course, a willingness on the part of the US's drug-happy citizens to get off chemicals).

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Fish Story: Due to the cholesterol scare, fish is now the hottest item in this nation. In 1975 tuna used to sell for 30 cents a pound (wholesale). In 1975 9,800 pounds of tuna was brought in at Long Island for a total take of $3,558. In 1985 765,000 pounds of tuna

was taken in worth $1.84 million. The wholesale price for tuna is now around $7 a pound for top-grade fish, and the Japanese (who use tuna for sashimi and sushi) will buy it right at the dock as it is landed.

There's an old Wall Street adage that runs, "If you want to get rich, find out what the poor people are doing -- and then do the OPPOSITE." So what have the poor people been doing for the last five years? The answer: going into debt in a big way. What constitutes the opposite action? Getting out of debt, buying the other guy's equity or debt, and building up assets. Actually, if you had stayed solvent (out of debt) and bought stocks or bonds over the last five years, you would now be in very fine shape (and, of course, this is just about what I've suggested that my subscribers do).

The Democratic party (and I thank Doug Casey for this info) has come out with a study that shows that the privately owned assets in the US total $10.6 trillion. The study notes that the "super rich" (420,000 households) since 1963 increased their share of the total assets from 25% to 35%. The super rich are those with assets of over $2.5 million. The "very rich" (another 420,000 households), according to the study, are those with assets of over $1.7 million. The "rich" have assets averaging $419,000. The top 10% in the US now own 72% of all the private assets in the nation.

"The rich get richer" is the tenor of the report. What I believe has happened is that those people in debt have just dug themselves deeper in debt (debt works AGAINST you through time). Conversely, those people with savings and little or no debt have piled up assets during the high interest rate period of the 1970s and '80s (income-producing assets work FOR you through time). Do you remember five or six years ago when the conventional blather was, "Go into debt, buy up hard assets, write off the charges, and get rich via inflation!" This is exactly what all the poor people did (after all, didn't the experts on TV tell them to do it?). So what happened? Inflation ended, real interest rates stayed high, everybody went into hock buying hard assets, and financial assets became the name of the new game.

Here's an interesting aspect of the new tax bill that tax-shelter expert Ed Drcar (of La Jolla's E.F. Hutton) discussed with me. Let's say you own a business. Your corporation has $100 in earnings. Your old corporate tax rate had a ceiling of 46% so you paid the taxes, and that left your corporation with $54. Next, you took the $54 out in the form of salary (or bonus or dividends), and you paid the top (personal income tax) rate of 50% on the $54. So the $100 that your corporation earned ended up providing you with a measly $27 after all taxes were paid. At that rate you were better off leaving the money in the corporation or buying something the corporation needed. In other words, the incentive was to enlarge or improve the corporations (i.e, by increasing corporate expenses).

Now let's look at the new tax bill. Your corporation makes the same $100. Your peak corporate tax is now 34%. So you pay the tax on the $100, and that leaves the corporation with $66. Then you pay out the $66 as salary (or bonus or dividends), and you pay the top new individual tax rate which is 28%. That leaves you with $66 minus $18.48 (for taxes) or $47.52 under the new tax law. Thus the new tax law leaves you with $47.52 after all taxes are paid as against $27 under the old tax law -- or a rise under the new tax law of 76% (that's right, seventy-six percent!).

So what's going to happen? Businessmen will have a huge incentive to "take the money and run" rather than reinvest it in their business. You don't believe it? Just go over those figures again. How will all this affect the US economy? Consumer spending will probably rise and capital investment will probably decline.

One of the most bizarre and mindless episodes in US agricultural history is about to take place. This is the spectacle of the US government providing the Soviets with multi-millions of dollars worth of US grain, and all of it's subsidized so that it is being sold to the Russians at far below the cost of production. Aside from the idiocy of the subsidization, the second irony is that US grain is now in tremendous surplus and production actually should be cut back. But instead, we are merrily producing unneeded grain and shipping it to the Russians at prices far below what they (the Russians) could produce it for.

With the advent of the new tax law, municipal bonds will be one of the very FEW tax-advantaged investments that taxpayers can buy. And the market is finally seeing this. Muni bonds in recent days have outperformed Treasuries. The yield on long-term California GO bonds has dropped to 6.60% (it was 9-10% a few years ago).

FUNDAMENTALS: It's a one-world market now, and "the rest of the world" (outside the US) is living on low, low wages. What's more, the rest of the world is beginning to produce, and produce BIG. The whole picture shows in the US balance-of-trade deficit -- which will probably rise to an incredible $170 billion this year. What's particularly ominous is that the US's balance-of-trade in agricultural and food stuffs (once a massive source of export earnings) is now plunging into negative territory. In May and June alone the US imported $419 million more in agricultural and food products than it exported!

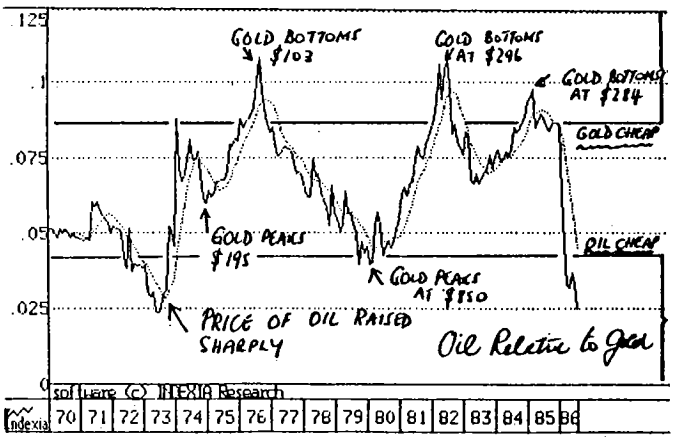
What's the conclusion? Here it is in a nutshell. The US has a sky-high standard of living, but its production costs are also sky-high. The rest of the world (mainly Asia and S. America) has a low standard of living but their production costs are low. Furthermore, the rest of the world is rapidly learning how to produce along very efficient lines. And just as important, the rest of the world is learning about technology. The inevitable result -- the US standard of living is going to go down, while the rest of the world's standard of living is going to go up.

The big US hope, as I see it, is that the US can LEAD in science and technology. We must compete in our best area -- or we're going to be in trouble. How do we do this? We must INCREASE SAVINGS and also increase spending on research and technology. Unfortunately, in my opinion, the new tax bill is going to head us in the opposite direction -- toward more consumer spending and less corporate investment and research (because of the loss of the investment tax credit). What's the answer? The answer is TO SEE THE PROBLEM. And the problem is a mind-blower.

I don't know. This nation grew great via its swarming tides of immigrants. Could that be where we should look now? Maybe the hope of America lies with our booming population of Asian-Americans. You think I'm kidding? Mull over these two paragraphs from the special education section of the August 3 New York Times:

> **Suddenly they seem to be everywhere. Last spring Asian-Americans were awarded the top five prizes in the Westinghouse Talent Search, the most prominent science award open to American high school students. Asian-Americans typically score around 520 out of a possible 800 on the math section of the college-admissions Scholastic Aptitude Test, about 30 points higher than whites.**
>
> **Although Asian-Americans make up only 2.1 percent of the population of the United States, they are surging into the nation's best colleges like a tidal wave. At Harvard University they constituted 8 percent of all undergraduates and 11 percent of the freshman class in the last school year. At the Massachusetts Institute of Technology they made up 19 percent of the school's undergraduates and 21 percent of the freshmen. In California, which has the heaviest concentration of the nation's 4.8 million Asian-Americans, the figures go even higher. One-quarter of the undergraduates last year at the University of California at Berkeley were Asian-Americans. And at the University of California at Irvine, outside Los Angeles, Asian-Americans accounted for more than a third of the freshman class.**

GOLD, OIL: Here's a fascinating chart that spurred me to thinking (chart courtesy of my friend, Tony Henfrey out of South Africa -- US address: PO Box 9137, Allentown, PA 18105). Here we see a chart showing the ratio of oil to gold. Throughout history there has been a tendency for gold and oil (often called "black gold") to move together. And historically when one or the other of



these two items has moved out of line, there has invariably been a corrective move which served to line up the price of oil and gold once again.

This ratio chart serves one main purpose: It shows us when gold and oil get out of whack with each other in terms of price. The chart also shows us when we are seeing an extreme in price divergence. Note that in 1973 gold became very expensive in terms of oil, and it was then that the price of oil rose sharply. Next, the price of gold declined and by 1976 gold had sunk to a low of 103. At the same time the ratio climbed far above 1.0 — into the zone which signifies that gold is too cheap compared with oil.

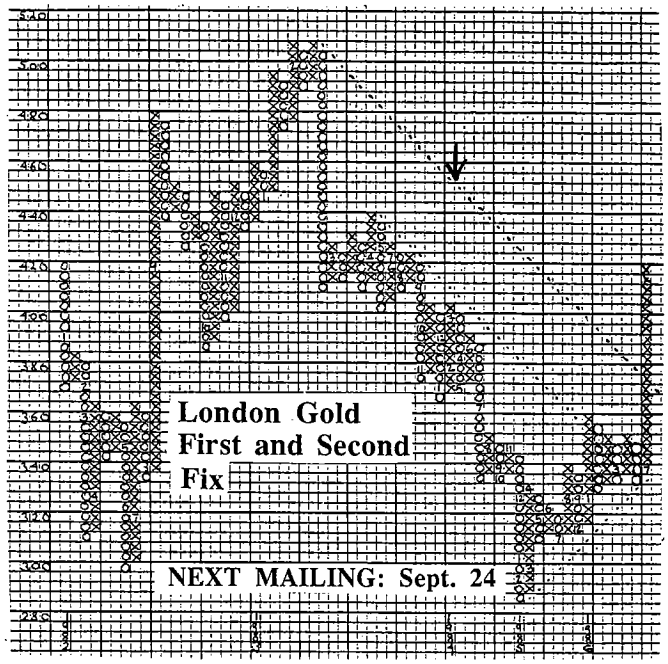
Next came the spectacular rise in gold to 850 in 1980 -- at which time the ratio showed that oil again was cheap in terms of gold (or that gold was expensive in terms of oil). In 1980 a bear market began for gold. The bear market took the yellow metal to 296 in early-1982, at which time the ratio indicated that gold was cheap in terms of oil. Gold stayed in the neutral to cheap zone until 1985. In 1985 the price of oil collapsed, and by 1986 the oil/gold ratio had fallen to .025, its lowest level in 13 years.

And that's exactly where we find the oil/gold ratio now. So what is the ratio telling us today? The obvious inference based on the history of this ratio is that either gold is currently too expensive in terms of oil -- or that oil is too cheap in terms of gold. What can we expect in the period ahead? The situation can go either way, but if I had to bet I'd bet that oil is now too cheap, and that the next major move of the ratio will be UP towards higher oil prices in relationship to gold. In other words, if I had to make a five-year commitment in either gold or oil at this point I would pick oil to move higher in price, while gold lags behind oil in relative strength (i.e., note the strength in the big oil stocks such as Royal Dutch and Exxon, very probably a harbinger of coming strength in crude).

Now let's turn to the point & figure of gold, and this is a 4 x 12 chart, which means that each box on the chart equals 4 points and only rallies or declines of 12 points or more and shown. Here we see gold breaking decisively above the secondary bearish trendline (arrow), and thus in a secondary sense there is no doubt but that gold has turned bullish.

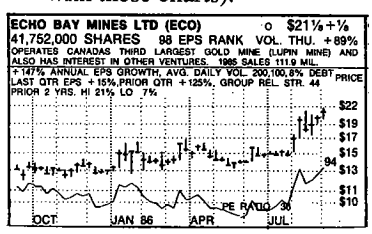
The P & F chart in the last Letter was a very long-term chart and on the basis of gold above 420 (which occurred on September 5) we can now say that the yellow metal has reversed its MAJOR six-year trendline, a trendline which comes down from the 1980 peak. On this basis, I don't see how we can escape the conclusion that gold is now signalling a new bull market.

I've been recommending the accumulation of gold coins for many months now, and last week the coins (Krugerrands, Maple Leafs, Kronas, Pandas) were selling over the 400 dollar mark, a juicy gain from when the coins were first recommended in the low 300s. Keep accumulating the coins. We're not buying them to make a killing, we're buying them for diversification purposes, or as I've often stated, we're buying them "just in case ... ."



Based on long and painful experience, I personally have a policy of never buying stocks which present unending or unsolvable problems. I place the South African gold shares in this category. Now mind you, I'm not saying these stocks are not cheap, and I'm not saying that people who buy them here won't end up making big money. I'm saying that I need at least 5 to 6 hours of sleep a night, and I've learned that when I buy problem stocks or stocks in problem areas I tend to come up short of those 5 to 6 needed hours of sleep. So my philosophy is, "I like profits, but I like my health even more." Thus Richard Russell won't be buying S. African gold shares. But if you have the guts, go ahead. By far the easiest way to buy them is via ASA which is a holding company for the S. African gold shares. It is traded actively on the NYSE (and at last count ASA was selling for a bargain discount of more than 30% BELOW asset value).

Below are charts (courtesy of Investor's Daily) of assorted N. American gold shares listed on US exchanges (add Agnico-Eagle on the AMEX and Campbell Red Lake on the NYSE, not included with these charts).


ECHO BAY MINES LTD (ECO) o $21⅛+⅛
41,752,000 SHARES 86 EPS RANK VOL. THU. +89%
OPERATES CANADAS THIRD LARGEST GOLD MINE (LUPIN MINE) AND ALSO HAS INTEREST IN OTHER VENTURES. 1985 SALES 111.9 MIL.
+147% ANNUAL EPS GROWTH, AVG. DAILY VOL. 200,100, 8% DEBT
LAST QTR EPS +15% PRIOR QTR +125%, GROUP REL. STR. 44
PRIOR 2 YRS. HI 21⅝ LO 7⅞
PRICE
$22
$19
$17
$15
$13
$11
$10
94
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OCT
JAN 86
APR
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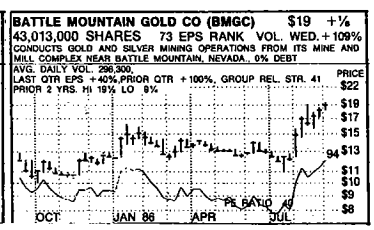

LATE NOTES: It's not a time to rest easy. The precious metals are flying, it's been four long years since the last cyclical "four-year low," and by many measurements the market is overvalued (yield on the Dow down to 3.4%, yield on the D-J Transports 2.1%, and, according to La Jolla's IQ Trends, the percentage of blue-chip stocks in the "undervalued zone" is down to a dangerously low 13%).

Yet the monetary background is strong, and market sentiment is nervous to fearful. From every quarter I hear talk of an impending major top. Again, I'm going to be guided by the action of the Averages themselves. If the market is in trouble, we're going to see the Dow below 1763.64 confirmed with a Transport break below 709.13. It hasn't happened yet, and keep that firmly in mind.

This market is not an easy one for the bulls to buy into or sit out. Take last week: Tuesday saw the Dow down 28 points, Wednesday saw the Dow up 11 points, Thursday saw the Dow up 38 points, and Friday saw the Dow down 20 points! A bull market climbs a wall of worry, and in this market the action itself is providing all the worry anyone could ever want.